

2nd Edition

Filing 2010

California Franchise Tax Board



The Future of California State Income Tax Filing - November, 2000

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California State Income Tax Filing
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Executive Summary

Dramatic events continue to transform the California landscape for businesses, individuals, and government agencies responsible for meeting public needs. At Franchise Tax Board, we interact with a variety of taxpayers and administer tax laws that account for nearly 60 percent of the state's general fund revenues. Our success in meeting the needs of California taxpayers depends on our ability to address demographic changes and technology trends that are reshaping how individuals and organizations interact with one another.

We first produced this document in 1995. Since then, unanticipated technological advances and the public's willing embrace of them have prompted this update. Our goal remains the same: to provide all taxpayers with the ease and convenience they demand when filing taxes and making tax payments. This document addresses the changes in product offerings we see emerging over the next 10 years as we work to realize this goal.

1990 – 2000: A Period of Transition & Preparation

Throughout the last decade, public and private organizations learned that a paper-based system does not meet the challenges of the changing world. We responded by reengineering our paper-based work processes with new technologies that provided immediate results and a foundation for future change.

Infrastructure Built to Support the Future.

Implementing our vision requires the same attention to detail and use of quality materials necessary to build a home that will withstand the test of time. The following systems comprise the infrastructure we developed in the past 10 years ensuring our future rests on a solid foundation.

- ✓ Taxpayer Information System (TI)
- ✓ Business Entity Tax System (BETS)
- ✓ Pass-Through Entity Audit & Support System (PASS)
- ✓ Accounts Receivable Collection System (ARCS)
- ✓ Integrated Non-Filer Compliance System (INC)

Customers Given Access to Information and Services.

Because our state's tax system relies on self-compliance, the ability of taxpayers to get the information they need is

critical. Easier taxpayer access to tax information, forms, and assistance helps ensure more accurate and timely filing and payment compliance. We initiated the following products to empower taxpayers.

- ✓ 24-Hour-a-Day Telephone Assistance
- ✓ 24-Hour-a-Day Internet Assistance
- ✓ Electronic Correspondence
- ✓ Video Conferencing

Paperless Returns Filed.

During the mid-to-late 1990s, we began the critical transition from being a paper-processing factory to being a high-tech electronic information gathering and processing enterprise. These successfully implemented projects provide the foundation of our paperless, return-free filing vision.

- ✓ e-file
- ✓ On-Line Filing
- ✓ TeleFile
- ✓ Magnetic Filing for Partnership Returns / K-1
- ✓ Non-Filer Return-Free Filing Project

Payments and Refunds Made Easy.

Each year, business entities and individuals send us over 12 million tax payments. To make it easy and convenient to accurately comply with the state's tax laws, we began offering taxpayers alternative payment methods. These payment and refund options support our expansion into paperless processing.

- ✓ Business Entity Electronic Funds Transfer
- ✓ Electronic Funds Transfer Installment Agreements
- ✓ e-Pay
- ✓ Credit Card Program
- ✓ Direct Deposit of Refund

Administrative Efficiency Improved.

During the 1990s, we implemented new systems and processes to promote administrative efficiency by improving how the department processes and manages its most critical asset - information. Specific initiatives included the following projects.

- ✓ Image Assisted Data Capture
- ✓ Modernizing and Re-engineering of the Cashiering System (MARCS)
- ✓ Power of Attorney Tracking
- ✓ Document Tracking

Filing in the 21st Century

Over the next 10 years, we will continue to move toward a taxpayer service and information-processing environment radically different from the paper-processing environment of the early 1990s. The hallmark of our vision will continue to be the ability of taxpayers to choose how, when, and where they get information, file returns, and make payments. We will also improve our ability to process and manage the tremendous volume of information we receive allowing us to speed refunds, resolve taxpayer problems quicker, and become more proactive in helping taxpayers avoid account problems. We will engage the most successful computer applications and work with established statewide e-government guidelines to enable this vision.

Transforming The Quality Of Our Customer Relationships.

Over the next 10 years, we will not only look for new avenues to provide information to taxpayers, but will implement programs that change how taxpayers interact with us. Specific initiatives will include the following.

- ▶ Building an Information Network
- ▶ Direct Account Access
- ▶ Seamless Tax Information

Filing Returns Electronically.

Over the next 10 years taxpayers will be able to choose from an increasing number of options for filing their state income tax returns. Whether using a PC, telephone, or interactive television from home; a public access terminal at the mall; a digital cell phone or PC notebook while traveling; or paper forms, taxpayers will be able to choose the method, time, and place that best suit their needs. By the year 2010, we anticipate that 59 percent of individual and 50 percent of business entities will file electronically using any of the following options.

- ▶ Expanded Electronic (Internet) Filing Programs
- ▶ Expanded Telephone Filing of Personal Income Tax Returns
- ▶ Interactive (Return-free) Filing for Personal Income Taxes

Making Payments and Receiving Refunds.

The move away from paper will also occur in the area of payments as society increasingly relies on electronic financial transactions in lieu of cash and paper checks. We project the volume of payments made with cash and paper checks will decline from the 99 percent we saw in 1995 to 55 percent by the year 2010. This will occur as taxpayers become more trusting and familiar with electronic payments options.

Improving Administrative Efficiency.

Our ability to collect, store, and manage information more efficiently means quicker refunds and more immediate identification and resolution of taxpayer problems. More efficient and effective administration of the state's income tax programs benefits all California's citizens and the state's business community because we spend fewer tax dollars administering tax law. Between now and 2010, our administrative efficiency will improve as the result of a number of projects, including the following.

- ▶ Expanded Image Assisted Data Capture, Access, and Storage
- ▶ Logically Integrated Systems
- ▶ Managing Information as a Strategic Resource

Critical Success Factors

We will implement new programs over the next 10 years to make taxpayer service, tax filing, and payment easier, and to improve administrative efficiency creating a system of tax administration dramatically different from the one we had just a few years ago. As we move forward, we must address significant issues. To successfully implement our vision, we must address these seven critical factors.

Individual Taxpayers Must Use New Systems.

To ensure successful implementation of new programs and services, we will survey taxpayers to find out how they want to access their tax information, file returns, and make payments, and we will implement new programs accordingly. Furthermore, we will make it a priority to build portals and interfaces that are easy for taxpayers to use and understand.

We Must Respond to the Needs of Business Taxpayers.

Part of our vision is to reduce the cost and burden on California businesses trying to comply with tax requirements. One solution is for businesses to extend their use of electronic commerce and information management into the tax arena. Another is to make it easier for businesses to understand and manage their income tax obligations by increasing their access to tax information. Especially critical will be our ability to use more accurate and timely information to help all taxpayers reduce or avoid the penalties and interest associated with tax errors.

We Must Work Successfully With Private Sector Interests.

We involve numerous private sector interests in creating tax-related products and services, helping taxpayers meet their income tax requirements, and reporting taxpayer information to us. We must work successfully with all of these interests to ensure compatibility between their products, services, processes, and systems, and ours.

Safeguarding Privacy and Confidentiality.

Electronic transmission of tax information and the ability of taxpayers to electronically access their own tax account information raise serious privacy and confidentiality issues. Because we place paramount importance on safeguarding taxpayer information, we will not move forward with any new project or program in instances when these issues are not adequately addressed.

Implementing Cost-Effective Technologies.

In keeping with our proven record for successful technology implementation, we are committed to prudently implementing new technologies. We will continue to do so with an understanding that there is tremendous value in establishing an electronic relationship with as many taxpayers as possible.

The IRS Must Take Similar Actions.

We implemented many projects and programs that helped us enable our vision and we will continue to do so. However, we are dependent upon certain federal initiatives if we are to fully implement our vision. They include: 1) building a more seamless interface between federal and state tax administration agencies, and 2) federal participation in electronic filing.

Our Filing Vision Must Be Flexible.

There has been a great deal of discussion recently regarding income tax reform. While any change in income tax laws will potentially affect how we administer California's income tax programs, we believe that the principles that underlie our vision are key to the successful administration of taxes in any form.

Conclusion

Continuing to provide our state with the best possible system of tax administration provides the key to our filing vision; one that makes paying taxes as easy as possible for all taxpayers, provides for efficient government operations, and generates revenue for California through the fair and effective application of the state's tax law. By building on past successes, working to resolve critical issues, and continuing to collaborate with appropriate private and public sector organizations, we are confident that the 21st century will bring the realization of this vision to the benefit of all Californians.

Our Tax Filing Vision

The following scenarios frame our vision for the future of income tax filing in California. They reflect our commitment to make filing and payment of taxes quicker, simpler, and more convenient. They also focus on the need to provide a wide variety of filing and payment options to meet the needs of a diverse tax-filing population. While we cannot control the complexity of the tax laws nor the amount of tax owed, we can employ new technologies, work in partnership with other public and private entities, and rethink old ways of doing business in order to make filing taxes less burdensome. Furthermore, we believe these measures increase the likelihood that California taxpayers understand and consequently pay the correct amount of tax up-front, thereby decreasing future taxpayer contacts and improving overall revenue collection for the state.

Scenario 1

Taxpayer has a return-free relationship with FTB.

Imagine coming home from the office one day in early February to discover a postcard from the Franchise Tax Board in either your physical or electronic mailbox. The sight of the postcard doesn't provoke anxiety. On the contrary, you expected it because you recently accessed your FTB account via your personal computer, interactive TV, or digital cell phone, and verified that all the information on your account was accurate. The postcard is merely a courtesy notice to inform you that FTB credited your refund to your personal bank account. Alternatively, if you owe any additional tax, the postcard indicates what payment option you chose: either paying with your credit card, transferring funds electronically from your bank account, or arranging for installment payments.

Now, let's imagine that when you access your account, you discover an income source credited to your account that doesn't belong to you, or that your charitable contributions were improperly deducted from your account. At the click of a button you correct the errors or omissions on-line while viewing your account. Or, if you prefer, a click of a different button takes you directly to your FTB account manager who personally works with you to correct the errors while you are on-line.

In less time than it takes to finish your morning coffee, you filed your state income taxes for another year.

Scenario 2

Taxpayer has a relationship with FTB via software providers.

Perhaps you're one of the growing numbers of individuals and business owners who use financial accounting software to track your personal or business income and expenses. Imagine, one day in early February, a contact from this company telling you that they have prepared and successfully submitted your income tax return to FTB. You gave them your power of attorney when you signed up for service so they could file your income tax return for you. (If you didn't want to give your power of attorney you could still access your tax account maintained by the software provider via your personal computer, interactive TV, Palm Pilot, or digital cell phone, and verify that the information was correct before they transmitted the return to FTB.) As a result, FTB automatically deposits your refund into your bank account and notifies you within 24 hours of the deposit. On the other hand, if you owed any additional tax, FTB notifies you that they received payment through the payment option you chose.

Scenario 3

Taxpayer has a relationship with FTB via tax practitioners.

Let's imagine you're one of the millions who have developed a trusted, long-term relationship with a tax professional who helps you navigate tax laws and systems. In this vision, you still depend on this person to meet your financial accounting needs. However, you no longer need to cart all your tax information to your preparer's office. Instead, she accesses your tax information via her computer through the secured FTB Internet portal. Since you gave her your power of attorney, she also files your tax return on your behalf.

You fully realize the benefits of using a tax professional when a problem with your tax account is identified. Since she electronically monitors your account, she knows whenever activity occurs. If the activity identifies an issue requiring attention, she resolves it even before you know about it. This kind of relationship takes customer service to new heights.

Scenario 4

Taxpayer has a direct relationship with FTB using existing filing options.

Perhaps you're one who takes great pride in your knowledge and ability to follow the changes and complexities of tax law. You prefer to assemble and prepare your income tax return without assistance. Imagine a system that allows you to choose how, when, and where you get the information you need to file a return, make a payment, or get your refund. For example, you might opt to get general or personal tax information using your interactive television after the kids are in bed on Sunday night. Or, you decide to file your return and make a tax payment using your credit card via the Internet on Saturday afternoon after you accessed FTB's database to check your tax account. You might even decide to file your return over the telephone during your lunch hour on Friday. Let's not forget the obvious; you can even mail a paper return on April 15th. The issue here is that you select the method that is easiest and most convenient for you.

Scenario 5

Business Entity Tax Filing

Now, imagine that you are one of the many Americans conducting business electronically. Given your increased reliance on electronic rather than paper transactions to communicate with financial institutions and trading partners, you want the ability to communicate with us electronically as well. Rather than printing and mailing a hard copy of the information in your computer database and relying on us to accurately re-enter the information into our database, you simply transmit your tax return electronically via our secure Internet portal or through your tax professional. You reduce the possibility of human error, get immediate acknowledgement that we received the payment or information, and ensure our ability to quickly resolve any tax problems that may arise in the future. Additionally, you can confirm the information on your business entity's tax account by logging onto our system 24 hours a day, seven days a week.

Our vision for the future of business entity filing does not differ greatly from the scenarios presented for the individual tax filer. However, unlike individuals for whom low cost, ease of filing, and quicker refunds are enough to encourage taxpayer participation, we anticipate business entities may need additional incentives. Some of these incentives might be as simple as providing on-line tax account access only to taxpayers with whom we have an electronic relationship. Access to all California state agencies that relate to the customer's business (i.e., Employment Development Department, Board of Equalization, Secretary of State, Consumer Services, etc.) might also provide adequate e-filing incentives.

Another might be to reduce the statute of limitations from four to three years for those with whom we have an electronic relationship.

There are approximately 800,000 business entities (corporations, banks, S corporations, exempt corporations, partnerships, limited liability companies) filing taxes in California. Of these, only 25,000 represent the large multinational-apportioning corporations. These multinational corporations typically have their own team of tax accountants and attorneys who handle all their tax issues. The other 97 percent are California business entities that are likely to rely on accountants and other tax professionals to handle their tax accounts with both IRS and us. The role of these tax professionals is changing. Their customers will rely more heavily upon them to handle all tax issues. They will find themselves performing the function of intermediary between their clients and the taxing authority. To serve their customers effectively, they will need to have direct on-line access to their customer's FTB account.

This report explains the impetus for our vision, the steps we have already taken toward realizing it, the numerous tasks we have yet to accomplish, and the issues we must resolve along the way. Read on for a description of the challenges and opportunities we face as we realize our vision.

The Changing World

Although it may be difficult to fully understand the breadth of changes that take place during one's lifetime, most Californians appreciate the vast changes that occurred over the last few decades and that continue today. Global competition, the Internet, and widespread use of technology all suggest that the world of the 21st century brings with it many new challenges for employers and workers. We expect these events to continue to transform the California landscape for businesses, individuals, and the government agencies responsible for meeting public needs.

We interact with a variety of taxpayers and administer tax laws that account for nearly 60 percent of the state's general fund revenues. We must address significant changes in state demographics and the technology trends that are reshaping how individuals and organizations interact with one another if we are going to be successful in meeting these new challenges.

Demographic Changes Addressed

Our success in meeting the needs of California's taxpayers is dependent upon our ability to respond to demographic changes that are occurring in California to an extent never before experienced by any state in the Union.

Population Growth.

With nearly 35 million people, California already has the largest population and growth rate of any state in the U.S. We expect the population to increase another 15 percent by the year 2010, and we expect a net increase of 17.7 million people over the next three decades. A proportionate increase in filed returns and customer contacts present tremendous challenges for us. Unless we prepare to accommodate these increases using more efficient technologies and more efficient administrative remedies, the department's processing and customer service delivery systems could collapse.

Baby Boomers Retire.

With the aging of those born between 1946 and 1964, there will be a significant knowledge drain as these seasoned employees retire from service over the next 10 years. This knowledge drain presents unique problems as the pool of skilled employment candidates needed to replace the retiring boomers is also expected to decline significantly during this same period.

Diversity Increases.

Demographers expect that 35 percent of the nation's international immigrants will settle in California over the next three decades. This equates to a net increase of 8.7 million immigrants in the state and more Californians with limited English speaking skills. Additionally, for a growing segment of taxpayers who emigrate from foreign countries it means they must learn about, and deal with, a voluntary income tax system for the first time in their lives.

Literacy Declines.

The most recent studies show California's adult literacy rates in decline. American businesses could lose over \$60 billion in productivity each year due to employees' lack of basic skills. According to the National Institute for Literacy, nearly 24 percent of California adults read below the third grade level. Nearly 60 percent cannot read beyond a sixth grade level and comprehension skills are even worse. Although the issue of literacy has become a cause for statewide concern, solutions continue to elude us, and rates continue to decline. Declining literacy rates make it especially critical for us to simplify how taxpayers get information and use the information to file their tax returns.

The Digital Divide Emerges.

Information tools, like personal computers and the Internet are increasingly critical to economic success and personal advancement. In a recent study, the National Telecommunications and Information Administration of the U.S. Department of Commerce finds that more Americans than ever before have access to telephones, computers and the Internet. At the same time, however, they found that there is a significant "digital divide" separating information "haves" from information "have-nots". The study found the following to be true in America.

- Households with incomes of \$75,000 and higher are *twenty times* more likely to have access to the Internet than those at the lowest income levels, and *nine times* as likely to have a computer at home.
- Regardless of income level, Americans living in rural areas are lagging behind in Internet access. Indeed, at the lowest income levels, those in urban areas are more than twice as likely to have Internet access than those earning the same income in rural areas.

Technology Trends Create Customer Demands

The income tax filing environment is being reinvented by the public's willingness to use new technology. Soon, processing paper returns will give way to the exchange of electronic data as the means of filing tax returns moves from paper and postage to PCs and telephone lines. One-stop shopping, 24-hour-a-day service, and convenient electronic customer service delivery systems are what the public will increasingly demand. New technologies will make it simpler for taxpayers to understand and meet complex tax requirements. Businesses or government agencies that do not respond to the public's demands for the convenience, ease, and simplicity offered by new technologies will not succeed, whether sales goals or general fund revenues measure that success. The following are some of the changes driving this transformation.

Personal Computers Become Common Place.

The National Telecommunications and Information Administration of the U.S. Department of Commerce recently ranked California 11th in the nation in relation to the number of personal computers used in households. Today, 50 percent of California households use a computer which represents a 19 percent increase from two years ago. Homes with income over \$100,000 are 65 percent more likely to have and use personal computers. In a recent survey of likely voters, 77 percent believe that government should provide grants to communities to ensure that schools, libraries, and hospitals have access to computers indicating a widespread acceptance and dependence on the technology. All studies indicate this growth will continue.

On-Line Services Grow.

Citizens use their home PCs to perform an increasing number of activities: home-shopping, purchasing airline tickets, on-line information searches, and banking and billing transactions. In 1996, only 10 percent of California households used the Internet. As of 1998, that number increased to 31 percent and today it approaches 50 percent. In addition, industry experts estimate that Internet traffic doubles every 100 days. We anticipate these figures to rise as more and more Californians become comfortable with the technology. Given this explosive growth, we expect citizens to demand access to these efficient and seamless delivery system when they file return data, access account information, and send or receive electronic payments.

e-Business, e-Government and e-Commerce on the Rise.

Taxpayers continue to conduct more of their business electronically and will demand that there are viable electronic options to conduct their tax business. Our challenge is to determine which of the many new technology products consumers will fully embrace before we invest heavily in technologies that may not survive the implementation phase. Creating e-business, e-government and e-commerce solutions will require us to act quickly when new technologies become available, but not so quickly that we lose sight of our customers' needs or wants.

Cash and Checks Yield to Electronic Currency.

The increase in e-business, e-government, and e-commerce, as well as the expanded use of credit/debit cards by individuals and businesses, foretells a decline in the use of cash and checks. The past 10 years have clearly indicated the public's acceptance of the ATM and credit cards. Consumers recognize their ease and convenience and business entities benefit from their efficiency. Electronic payments have become the norm in large corporate environments. As citizens move away from cash and checks to the electronic purse, government agencies must offer easy-access payment systems for all fees and taxes currently received from citizens.

The message is clear; the world is changing. We are changing with it. Let's look at the last 10 years to see how we have prepared for these changes.

1990-2000: A Period of Transition & Preparation

Public and private organizations are learning that a paper-based system is ill suited to meet the challenges of the changing world. Throughout the decade of the nineties, we began to respond by re-engineering our work processes with new technologies that provided immediate results and a foundation for future change. Current efforts include modernizing our basic system infrastructure, providing more customer service delivery options, and more taxpayer options for filing returns and making payments, and increasing administrative efficiency.

Infrastructure Built to Support the Future

Imagine yourself in need of a new home and because you couldn't find just the right one, you decide to build it yourself. You want a home that will accommodate your growing family and will function as your family's gathering place as your children, and your children's children, grow. You build your new home on a solid foundation using the best material available that will withstand the test of time. Building our vision requires this same attention to detail. The following efforts outline the work we have done in the past 10 years to ensure our future rests on a solid foundation. Without the successful implementation of these projects we could not bring our vision into focus.

Taxpayer Information System (TI).

In 1993, we implemented an automated system for processing personal income tax returns. The system, known as the Taxpayer Information System (TI), moved the taxpayer information and accounting of personal income tax workloads into a new age of on-line, real-time processing. For taxpayers, TI means having many of their tax issues resolved immediately, rather than days or weeks after they make a call or write a letter to us. It also assures taxpayers of having the current status of their accounts readily available to our customer service representatives and other staff, since transactions immediately post to the system and interest and penalty computations update automatically. From an administrative perspective, TI is flexible, allowing quick system changes in response to new tax legislation. It also drastically reduces the need to pull paper documents from our central files, or use paper documents to perform account transactions.

Business Entity Tax System (BETS)

In 1996, we implemented the Business Entities Tax System, replacing an outdated bank and corporation master file system. The new system moved business entity

tax processing workloads to an enhanced on-line environment. The system allows customer service representatives to respond immediately to taxpayers' inquiries regarding account balance, refund status, and bill status. They can also immediately post taxpayer-provided information since BETS provides a real-time update environment. The system allows for enhanced interface to our collection's program account processing system, the Pass-Through Entity Audit and Support System (PASS), and enhanced functionality supporting our audit program. Administratively, BETS is flexible, allowing for ease of maintenance when responding to new legislation or enhanced system interface requirements.

Pass-Through Entity Audit & Support System (PASS).

In 1997, we implemented a decision support system designed to help auditors perform business entity audits. And, in 1998, we expanded the system to support attorneys in resolving legal cases. The system compiles and organizes information from various sources including federal and state return information. It allows for automated and on-line processes to 1) identify non-filers, 2) select business returns for audit, and 3) provide on-line displays of information that management can use for making decisions. Audit activities performed in the Pass-Through Entity Audit & Support System are audit modeling, ownership and income tracing, case assignment and management, correspondence composition, case planning and history, and time and production reporting.

Accounts Receivable Collection System (ARCS).

In 2000, the Accounts Receivable Collection System was implemented so that personal income and business entity tax program collection accounts can be viewed from the same platform. Features of this system that will increase collection effectiveness and efficiency include:

- Advanced inventory management and priority assignment, allowing us to work the most collectable accounts first.
- Improved tracking methods to identify why, when, and how customers contact us allowing us to provide better customer service.
- Enhanced automated processes for sending billings and correspondence.
- Improved processes for generating management reports.

This project brings us closer to our vision by providing our staff (and by extension, our customers) with broader collection account information access. It also pioneers

case-management tools that could significantly improve our administrative capabilities.

Integrated Non-Filer Compliance (INC) System.

In 1998, we began to build the first phase of the INC system. The project design calls for five phases with a completion date of January 2002. When fully implemented, INC will redesign and replace the aging individual and business non-filer systems in use today. Acting as an information warehouse, INC will identify non-filers by accurately associating income information with: 1) individuals and business entities who have not filed state tax returns, and 2) information reporters who have failed to meet their filing requirements. The INC system will give us the tools necessary to eliminate unnecessary taxpayer contacts as well as improve customer service. It will enable non-filers to access their FTB account to make corrections, ask for tax forms, get answers to commonly asked questions, verify a balance due, and follow any activity on their account. This project will give us a strong foothold in technologies that will make our return-free vision a reality.

Customers Given Access to Information and Services

Because our state personal and business entity tax systems rely on self-compliance, the ability of taxpayers to get the information they need when they need it is critical. Unanswered questions can often become tax return errors and the lack of a necessary form or schedule can mean missed revenue for the state or an undeliverable refund for the taxpayer. The easier it is for taxpayers to get tax information, forms, and assistance, the more likely it is that they will pay the correct amount of tax on time. Here are some of the initiatives we have implemented to enable that to happen.

24-hour-a-day Telephone Assistance.

In 1993, we installed an Interactive Voice Response System (IVR). In 1998, we fully integrated the IVR with the department's phone and voice systems, enabling taxpayers to contact us around-the-clock for answers to their tax related questions. In 1999, the IVR handled over 5.5 million calls.

The IVR hosts 21 tax and non-tax applications that allow callers to:

- TeleFile personal income tax returns.
- Access information from their personal income tax accounts such as their refund status, current balance due, and recent payment information.
- Update information on their personal income filing enforcement file.
- Order most tax forms and publications.

- Obtain general law and procedural information about personal income tax, various business entity taxes, the Homeowner and Renter Assistance program, and several audit and collection workloads.
- Transfer to FTB staff in the appropriate work areas.

Most of these applications are available in both English and Spanish, an important option considering California's changing demographics. In addition, the IVR allows callers to connect to FTB staff with the expertise needed to answer their particular questions.

24-hour-a-day Internet Assistance.

In 1995, we established a Website to provide information and services to the public over the Internet. In 1999, 9.6 million visitors to the our Website were able to:

- Download over 9 million tax forms and publications.
- Log over 65 million hits to the Website.
- Submit over 21,000 e-mails requesting information or assistance, or commenting on FTB services, to the Webmasters, customer service staff, the Executive Officer, or taxpayer advocate staff.

Services added recently to our Website have enabled visitors to:

- Verify the status of their current year personal income tax refunds.
- Review our audit and collection procedure manuals,
- Access basic information about our public services in Spanish.
- Hear broadcasts of FTB and BOE Board meetings, and
- Participate in our first "Chat with Tax Experts" just before the April 17th, 2000 filing due date.

Electronic Correspondence.

Electronic Correspondence is an alternative method for tax professionals to request assistance from us including account-specific information, and is available 24 hours a day, 7 days a week. In 1993, we began providing this exclusive service to attorneys, enrolled agents, and certified public accountants through a network of personal computers equipped with fax/modems. When we receive a fax, a customer service representative prepares and electronically responds to the sender within five to seven days, compared to a 21 day processing cycle for traditional paper correspondence received via the U.S. mail. There has been a 300 percent increase in the use of this service over the past five years.

Video Conferencing.

A recent pilot project, conducted to test the feasibility of an interactive, face-to-face remote customer service option, allows the taxpayer access to a customer service

representative by picking up a telephone receiver located at a remote site. The taxpayer automatically connects to a representative located in our call center in Sacramento. The benefits of this option are far reaching. First, it allows us to centralize our customer service function to ensure consistency and quality of service, while at the same time addressing the geographic challenges of getting information to the taxpayer when a face-to-face contact is preferable or necessary. This customer service pilot is the precursor of realizing our long-range vision of taxpayers having the option of face-to-face contact via their personal computer.

Paperless Returns Filed

In the past, processing returns meant receiving paper and manually transcribing limited return information into a mainframe database. During the mid-1990s, we began implementing changes to make the critical transition from a paper-processing factory to a high-tech electronic information gathering and processing enterprise. The success of our electronic filing program depends on taxpayer acceptance and participation. When marketing the program, we highlight incentives that promote taxpayer participation. For example, within seven days of receiving an electronic return, the State Controller's Office issues the taxpayer's refund or, beginning in 2000, an electronic refund could be transferred directly to the taxpayer's bank account. Other benefits to taxpayers include receiving fast communication regarding return status, and assurances that they have submitted virtually error-free returns.

Here are some successfully implemented initiatives that provide the foundation of our paperless, return-free filing vision.

e-file.

In 1994, we launched a personal income tax e-file program based on the successful IRS program in which they collaborated with commercial tax preparation software companies and tax preparers. Our programs and those of IRS require taxpayers to use the services of an approved "electronic return originator" (typically a tax preparer) and/or "transmitter" to e-file returns. At the client's direction, a preparer "originates" the electronic transmission of the tax return data directly to us via modem (not via the Internet) or to a bulk "transmitter" service that prepares and reformats the data for subsequent modem transmission. Some preparers impose e-file transmission fees on clients while others may charge a consolidated preparation and e-file transmission fee. More than 10,000 tax practitioners participated in our e-file program in 2000 and were responsible for e-filing over 1.5 million returns.

On-line Tax Filing.

We began to accept e-filed tax returns from commercial web-based on-line tax filing services in 1998 (after a small 1997 pilot), following the IRS rollout of its program in 1997. In essence, a commercial on-line filing company offers web-based tax preparation and e-filing services in place of an in-office tax preparer. On-line companies make use of the Internet for individual customer transactions, but subsequently batch and transmit tax return data to us using a dial-up modem system. Thus, there is not a "direct" taxpayer-to-FTB transaction. On-line filing companies are bound by published administrative program guidelines requiring that they keep taxpayer data confidential and that they retain or control signature documents per FTB procedures. As is the case with conventional preparers, on-line companies are free to set fees and other terms and conditions for the use of their services. In 1998 and 1999 several software providers offered no-cost tax preparation and e-filing to taxpayers filing Form 540EZ or with an adjusted gross income of \$20,000 or less. On-line filing grew by more than 217 percent from 1998 to 1999, and in 2000 we expect another year of growth approaching 150 percent (about 510,000 on-line returns total).

TeleFile.

TeleFile is a paperless filing option that allows taxpayers to file their personal income tax returns using a touch-tone phone. Initiated as a pilot project in 1996 using a pool of 100,000 Form 540EZ filers, its success prompted full implementation in 1997. Unlike preparer e-filing and on-line filing, telefiling offers a direct taxpayer-to-FTB program for "do-it-yourself" filers who do not use the services of a tax preparer or commercial on-line company. In 2000, nearly 260,000 taxpayers used TeleFile. Since the inception of the program, taxpayers have telefiled more than 794,000 tax returns. Without expansion of eligibility criteria, we project that TeleFile participation will remain flat or gradually decline in coming years as taxpayers gravitate to other e-filing options. However, based on use of the recently introduced Form 540 2EZ¹ return in 2000, we decided to expand the TeleFile program to include the Form 540 2EZ audience. Adding this audience will double the TeleFile eligible audience to nearly 4 million taxpayers.

¹ In 2000, the department introduced the simplest and smallest tax form (540 2EZ) as an option for tax year 1999. The 2EZ return was available to most taxpayers with income of \$50,000 or less for single filers or \$100,000 for married filers. The 2EZ, filed either electronically or in paper form, is approximately half the size of other tax forms and requires fewer steps to complete.

Magnetic Filing for Partnership Return/K-1s.

In 1996, we began processing Schedule K-1s from magnetic media submitted by California partnerships. Magnetic media includes CD, diskette, tape cartridge, or magnetic reel and provides a faster and more convenient option than filing paper with us. Magnetic media can be processed in a fraction of the time it takes to process paper. Nearly 12,000 K-1 records can fit on a single diskette. If filed on paper the reporter of these same K-1s would need to transport and pay postage for four boxes at 15x12x10 inches each. Although federal law requires reporters with more than 100 K-1 information returns to file using magnetic media, California law does not. Filing magnetically is voluntary, providing a tremendous benefit to both partnerships and us, as the participating partnerships can have up to 80,000 partners. Partnerships filed over 1.2 million K-1s in 1999 using magnetic media.

Non-Filer Return-Free Filing Project.

In 1998, we began a study designed to determine if a return-free filing option would influence voluntary compliance rates among non-filers. There were 2,100 non-filers included in the first year of the study. We limited the study participants to those who had either filed a federal return from a California address or were wage earners with a single California employer. We sent participants a letter indicating total income and income source, with state tax, penalties, and interest calculated for them. If the amount provided was agreed upon, the non-filers merely signed and returned the letter to us. Results indicate that study participants were 38 percent more likely to pay their tax than those who were sent the traditional non-filer letter. The project will expand in future years with a goal of providing a return-free filing experience for nearly 30 percent of all identified non-filers by the year 2005. Experiences learned from this project set the stage for implementing our vision of providing a return free filing option to California taxpayers before 2010.

Payments and Refunds Made Easy

Each year, business entities and individuals send us over 12 million tax payments. To make it easy and convenient to comply with the state's tax laws and pay the appropriate amount of tax, we began offering taxpayers alternative payment methods. These payment options also facilitate our expansion into paperless processing. The following options outline our offerings to the public to make payments easier and more convenient.

Business Entity Electronic Funds Transfer (EFT).

Beginning in 1993, legislation required corporations making payments of \$50,000 or more, or whose total tax liability exceeds \$200,000 per year to make tax payments using EFT, an electronic method of instructing financial institutions to transfer funds from a taxpayer's bank account to the state's account. The legislation further required lowering the tax payment threshold for mandatory EFT payments from \$50,000 to \$20,000, beginning in January 1995. Today, nearly three percent of all corporations use EFT for payment submissions. Although less than three percent of business entity payments are made using EFT, they represent 75 percent of all business entity receipts.

For the state, the major advantage of receiving revenues via EFT is that money is in the bank sooner, collecting interest for the state's general fund. Recent estimates attribute an additional \$19 million in interest to our EFT program.

EFT Installment Agreements.

In 1997, the department expanded EFT to allow personal income taxpayers and child support debtors to enter into EFT installment agreements. The default rate on EFT installment agreements is only three percent compared to 40 percent for traditional installment agreements. Although these statistics are impressive, there was a bigger advantage realized as a result of implementing this payment option; the positive change in our relationship with the taxpayer. We are losing the "overseer" image and creating an image that highlights our role as problem solvers concerning issues relative to timely payment of personal tax liability. Installment payments provide a convenient way for taxpayers to pay their tax debt by fitting it into a monthly payment routine.

e-Pay.

In 1999, personal income tax filers who e-filed their tax return had the option of paying their tax liability using e-Pay. Under this payment option, taxpayers provide personal banking information to us and we automatically withdraw funds from their accounts on the date they specify. If taxpayers file before the return due date, they can set up the e-Pay option to debit their bank account on the due date of the payments. Nearly 60,000 taxpayers requested this payment option. Beginning in 2000, this payment option was also made available to TeleFilers and nearly 6,500 of them made payments using e-Pay.

Credit Card Program.

Another payment option most taxpayers are familiar with is payment by credit card. Working with the Department of General Services, other state tax administration agencies, and credit card associations, we implemented a cost-effective program, fully introduced during the 1999 process year. Using Discover, Mastercard, or American Express credit cards, taxpayers can pay their personal income tax estimates, extension payments and tax balances. We anticipate nearly 22,000 credit card payments in 2000 to pay personal income tax liabilities of over \$27 million.

Direct Deposit of Refund (DDR).

In 1998, the department implemented Direct Deposit of Refund as a pilot for e-file returns only. In 1999, we expanded the pilot to include TeleFile returns. Beginning in 2000, even taxpayers filing on paper could have their refunds deposited directly into their bank accounts. The benefit to the taxpayer is a faster refund. During the 2000 process year, about 1.3 million taxpayers took advantage of this service.

Administrative Efficiency Improved

The well-planned use of technology will allow us to maintain efficient operations and effective tax administration programs. During the early 1990s, we implemented new systems to promote administrative efficiency by improving how the department processes and manages our organization's most critical asset — information. The following list of initiatives outlines our efforts at improving administrative efficiency.

Image Assisted Data Capture.

Image technology is an important step in our long-range plan to transition from paper processing to electronic information management. Although it's difficult to stop thinking of us as a giant paper processing enterprise, the department does recognize that a primary goal is obtaining data that can be converted into information. Imaging technology is a way to capture data from paper and make it available to users at workstations. Imaging technology provides fast, accurate processing of returns and allows us to be more responsive to taxpayers. In 2000, we processed 51 percent of all returns using our image system. For the first time we are processing more returns using image technology than manual processing.

Modernization and Reengineering of the Cashiering System (MARCS).

MARCS is yet another automated system using image-based technologies for capturing and processing data electronically and at the same time providing the necessary cashiering functions critical to us. Its primary function is to replace our aging cashiering system. While the Image Assisted Data Capture System mentioned above handles only machine printed, "scannable" refund returns, MARCS handles both machine printed and hand printed documents including balance due returns. MARCS was brought on-line for the 2000 processing year, creating images of both documents and checks and providing an automated workflow for balancing batches, depositing checks in the bank, and processing the payment documents and tax returns electronically. MARCS currently handles nearly 90 percent of all personal income tax payments. By the end of June 2001, MARCS will have replaced all manual cashiering workloads (approximately 12 million items annually) with this new image-based automated approach.

Power of Attorney.

In 1999, acting in response to suggestions from the tax representative community, we implemented a database for tracking authorizations from power of attorney documents. This database allows authorized users throughout the department to view the authority granted by specific taxpayers on the power of attorney document through a web-based browser interface. In 2000, we will upgrade and expand the database to include the ability to mail duplicate notices to representatives as designated through the power of attorney document. This project is an important piece of our return free filing vision.

Document Tracking.

In 1998, we implemented a tracking system that allows users to track movement of business entity returns from the time of their entry into our computer system. Document tracking makes accessing returns more efficient and thus has the potential for improving customer service should taxpayers request a copy of their return. We plan to explore the feasibility of expanding this system to include tracking personal income tax returns and other department documents systematically. We, along with taxpayers, will realize the real potential of this project as we consider a future customer service option of making taxpayers' returns available on-line upon request.

Fed/State Partnership.

During the past five years we have participated in several successful partnering efforts with our sister tax agencies, the Employment Development Department, the State Board of Equalization, and the Internal Revenue Service. The Fed/State Partnership is a product of these efforts. The goal of the partnership is to pool resources and information so the agencies can improve taxpayer compliance and customer service. This partnership will provide the administrative infrastructure model needed to respond effectively and quickly to the challenges of the next century.

Modernized system infrastructure, expanded customer services, new filing and payment options, and administrative efficiencies implemented between 1990 and 2000 provide the foundation for the tremendous changes anticipated over the next 10 years. Let's look into the 21st century and see what's in store for the next 10 years.

Filing in the 21st Century

We have traveled a good distance toward our vision in the past 10 years, but the landscape continues to reflect the familiar paper environment of which we have grown accustom. Over the next 10 years, however, we will move to a taxpayer service and information processing environment that is radically different from the traditional paper processing environment of the early 1990s. In so doing, we will not only capitalize on the technological revolution that continues to change the American landscape, but also on changes in the paradigms underlying tax administration in California.

The hallmark of our vision will continue to be the ability of taxpayers to choose how, when, and where they get information, file returns, and make payments. We will also improve our ability to process and manage the tremendous volume of information we receive, thereby allowing us to speed the issuance of refunds, resolve taxpayer problems more quickly, and become more proactive in helping taxpayers avoid account problems. We will engage the most successful computer applications and work with established statewide e-government guidelines to enable this vision.

Transforming the Quality of our Customer Relationships

Over the past few years, we have created several new avenues for taxpayers to access general tax program information. For instance, we launched our Internet home page (www.ftb.ca.gov) in 1995. Through this medium we provide up-to-the-minute general tax information to the public with links to all our tax partners. Refund status application, implemented in 1999, allows personal income taxpayers to verify the status of their current year refunds after providing acceptable identifying and authenticating information. The site also provides information about, and links to, a secure Website where taxpayers can use their credit cards to make on-line tax payments. Additionally, the site provides a review of frequently asked questions as well as an opportunity to send e-mail to a customer service representative or our Executive Officer.

Over the next 10 years, we will not only look for new avenues to provide information to taxpayers, but will implement programs that will change how taxpayers interact with us.

Building an Information Network.

Because of several FTB initiatives in recent years, taxpayers can now access general tax program

information in a number of different ways, be it over the phone, from a personal computer using the Internet or by walking into a district office. As technology continues to advance over the next 10 years, we will continue to improve the functionality and capacity of these existing avenues and link them together to create a comprehensive information network. In addition, we will continue to assess new technologies and opportunities as they become available, to determine their potential to help us better serve the information needs of taxpayers. In much the same way that telephones have become a necessity in nearly every American household and business, computer use will also become routine. These computers will allow California taxpayers access to Internet and portal technologies that will become important avenues for electronic interaction with us.

As a result of our efforts to expand, link, and add to existing information delivery systems, taxpayers in the year 2010 will have an easy time getting the tax information they need. Information will be available 24 hours a day, seven days a week. It will be accessible from home, office, car, and airplane phones, as well as public facilities such as libraries, local schools, and perhaps even grocery stores.

Direct Account Access.

Currently, we provide taxpayer account information collected and maintained by us only in response to a specific question or problem. We also limit our response to whatever information is relevant to the question or problem. Additionally, access to information is not always easy because there are several different storage media where information resides. In the future, information warehousing and electronic technologies will provide us with the opportunity to change that paradigm by giving taxpayers direct access to their own tax account information, including information reported to us and other state agencies by taxpayers' employer, bank, mortgage lender and others.

This means that taxpayers will not need to correspond with us or contact a customer service representative to find out such things as how we applied a payment, when we received and processed a return, the status of a tax lien, or the amount of wages reported to us by their employers. Rather, taxpayers will use a personal computer to access their own account information directly. If they experience difficulty navigating through their account, the

taxpayer will access an on-line help feature or chat with a live customer service representative via instant messaging technology. For those who require face-to-face voice contact, video conferencing will also be available. Using this information and the on-line help features, taxpayers will have more control over how they make their tax payments.

Seamless Tax Information.

We are one of three organizations charged with administration of taxes in California. While we administer California's income tax programs, the Employment Development Department (EDD) administers employment taxes, including income tax withholding, unemployment, and disability insurance. The State Board of Equalization (BOE) administers the state's sales and use and numerous excise and special taxes. Of course, the Internal Revenue Service (IRS) administers federal income and employment taxes within the state.

Because taxpayers are not always aware of the distinctions between taxes or the departments that administer them, they sometimes contact the wrong organization seeking assistance. In other instances, taxpayers subject to several types of taxes (e.g., a store owner with several employees) must contact and report information to each tax administration agency separately. We have already begun working with EDD, BOE, and IRS at both the state and national levels to make it easier for taxpayers to get answers from, and report information to, all of these tax administration agencies. We have established taxpayer service centers throughout the state where taxpayers can go to meet with representatives from each of the state tax agencies. We have also established the Cal/Fed Website that provides California taxpayers with a single place to access information regarding personal, corporate, sales, employer and other types of state and federal taxes.

Additionally, cross-training and co-locating staff, expanding prerecorded information to include other taxes, linking Internet Web-sites, and stocking the most requested forms of the other organizations, is helping to achieve seamless service among the four tax agencies. Another recent initiative (One Call Connect) links the automated call processing systems and electronic information networks establishing seamless interconnectivity between FTB, EDD, and BOE. For example, a new employer who mistakenly contacts us to learn about employment tax requirements still gets the correct information and forms. A business owner with questions about income, employment, and sales taxes gets answers related to all three taxes with a single phone call.

At the national level, we continue to build on past collaborations with the IRS in taxpayer education. We are currently working with the IRS, Social Security Administration and other state and federal agencies on a Simplified Tax and Wage Reporting System (STAWRS) project. As the name implies, the goal of this project is to make it easier for employers to provide employment tax payments and information to the federal government and the states. The key aspects of the project are:

- Single Point Filing – Provide employers with a single point-of-submission for most of their employment tax filings and payments. The system will then forward information and payments to all affected jurisdictions.
- Streamlined Customer Service – Provide current and accurate tax information to employers electronically via the telephone, the Internet and person-to-person, while demonstrating the benefits of on-line transactions. Also, simplify the process for application and distribution of both federal and state employer identification numbers.
- Simplified Requirements – Provide greater consistency between federal and state employment tax and wage reporting laws (harmonization), so that regulations, instructions, procedures, forms, and filing schedules are simpler and more understandable.

Initiatives such as these help employers to understand the interrelationships between the differing tax authorities. These groups are optimally positioned to market the products that will alter taxpayer behavior needed to fully realize our 2010 vision. This is the primary reason we will continue to support efforts that strive to build a more seamless taxpayer interface between state and federal tax administration agencies.

Electronic Return Filing

Over the next 10 years taxpayers will be able to choose from an increasing number of options for filing their state income tax returns. Whether it is using a PC, a public access terminal, a telephone, an interactive television, a digital cell phone or paper forms, taxpayers will be able to choose the method, time, and place that best suits their needs.

As more and more taxpayers choose other methods of filing, we project that the number of paper returns filed will decline dramatically. Where we received virtually all personal and business entity income tax returns on paper in 1995, we anticipate that only 41 percent of personal income tax returns and 50 percent of business entity returns filed in 2010 will be on paper. (For more detailed projections, see Appendix A.)

Expanded Electronic (Internet) Filing Program.

In 1995, only one percent of taxpayers filed their state personal income tax returns electronically. In 1999, the percentage of taxpayers who filed electronically rose to nearly 12 percent. In 2000 we expect to see 18 percent of all returns filed electronically. Over the next 10 years, this figure will steadily increase to an estimated 59 percent as taxpayers become increasingly accustomed to communicating and transacting business electronically and we expand the scope of our existing electronic filing program.

This means that once adequate safeguards are built into the system and we are able to build a relationship of trust with taxpayers by proving that the technology is safe, they will file electronically. As early as the 2001 filing season, we will offer a direct e-filing option to taxpayers using software to prepare and electronically submit their return.

We plan to pilot an Internet-based electronic filing program for business returns (e.g., corporation and partnership returns) by the end of 2003. The same advantages that have influenced more and more businesses to communicate with their suppliers, customers, subsidiaries, agents, and others using Internet technology apply to communications with us as well. For example, electronic transmission of data eliminates the cost of manual processing at both ends, ensures error-free transmission of data, speeds the flow of information, and provides the sender with an electronic acknowledgment that we received the information. Additionally, once a business entity establishes an electronic relationship with us it will have direct access to its tax accounts enabling direct management. Given these advantages, our initial projections are that 35 percent of corporations and 75 percent of partnerships will choose to file electronically by the year 2010. (For more detailed projections, see Appendix B and Appendix C.)

Expanded Telephone Filing.

Telephone filing offers tremendous convenience to taxpayers with all the benefits of electronic data transmission including faster refunds and the elimination of re-keying errors and cost. Recent figures indicate that participation in TeleFile has declined by a small percentage over the past two years. We anticipated this decline, as those from the total TeleFile universe are generally eligible to participate in the program for only two years because of set income limitations. To counteract this decline and to continue to leverage this technology we will expand the eligible universe to include all Form 540EZ and Form 2EZ filers by 2001. By including these new participants in

TeleFile the eligible universe should expand from the current 1.8 million to nearly 4.0 million. By the year 2010 we expect to see eight percent of the all returns submitted using TeleFile. (For more detailed projections, see Appendix A.)

Making Payments and Receiving Refunds

The move away from paper is also occurring in the area of payments as our society comes to rely increasingly on electronic financial transactions in lieu of cash and paper checks. In 1995, taxpayers made 99 percent of all payments with either cash or paper checks. These traditional payment options require extensive manual handling leading to possible error, and costing more time and money to process. In 1999, taxpayers made five percent of their payments using electronic options (i.e., electronic funds transfer, e-payments, or credit cards), which was a 39 percent increase from the previous process year. During 2000, that number increased to nearly seven percent. By the year 2010 we expect 55 percent of all payments will be electronic. (For more detailed projections, see Appendix D.)

Expanded Electronic Payment Alternatives.

By the year 2010, taxpayers will have a number of electronic payment options that they can combine with any filing alternative, be it electronic, telephone or paper. The possibilities include:

- Personal computers, public access terminals, or other technology (e.g., interactive television or digital cell phones) to direct a transfer of funds from the taxpayers' bank to ours. By the year 2010, this will likely become the most common method for us to issue refunds to taxpayers.
- Personal computers and public access terminals equipped with the ability to read a debit card or credit card for making a payment.
- The availability in taxpayer service centers, tax preparers' offices, and selected banks with point-of-sale payment devices.

As the electronic banking industry continues to evolve, other possibilities will appear on the horizon. We will continue to evaluate the potential of new technologies for use as a tax payment method.

Improving Administrative Efficiency

While taxpayer service, filing, and payment environments directly impact taxpayers, projects implemented to improve administrative efficiency also have a positive, albeit more indirect, impact on the lives of California's taxpayers. The ability to collect, store, and

manage information more efficiently will mean quicker refunds and more immediate identification and resolution of taxpayer problems. In addition, more efficient and effective administration of the state's income tax programs will benefit all California's citizens and the state's business community by improving the state's fiscal condition.

Expanded Image Assisted Data Capture, Access, and Storage.

Image technology will continue to play an important role in processing tax returns during the next 10 years. By 2010 we hope to have less than 40 percent of returns submitted on paper. Additionally, we will ensure that 95 percent of personal income tax returns filed on paper will be imaged in order to capture and store the information they contain. A new technology that will enhance our capabilities in this area is the use of 2-D bar codes. We are investigating the use of 2-D bar code technology as a possible means for replacing the "scannable" format currently used for computer prepared (machine print) tax returns. The advantage this technology affords is that it captures even more tax return data from schedules and forms accurately and efficiently and addresses long-term data storage needs in warehousing paper.

Although we project that the percentage of returns filed on paper will decline dramatically by the year 2010, we recognize that millions of taxpayers will continue to file their returns on paper for decades to come. Therefore, paper imaging will continue to be an important aspect of improving our administrative efficiency. In fact, it isn't until the year 2010 that we anticipate electronic and telephone filing will overtake paper as the most common method of filing. Consequently, image-assisted data capture will be the predominant method for processing returns at FTB for another 10 years.

Over the next several years, the impact of image technology on the department's operations will expand from data capture to include long-term access and storage. New information management systems will provide access to imaged returns, virtually eliminating the need to manually pull paper returns out of storage so that internal and external customers will have immediate, real-time access to taxpayers' records.

Logically Integrated Systems.

Just as we are working with Employment Development Department and the Board Of Equalization to provide a seamless interface to taxpayers, we are also improving the links among our organizations' internal systems as a means of refining our ability to share information in a complete, accurate, and timely manner. Although this sort

of logical integration may seem mundane to the public, it is a key component underlying the implementation of many of the taxpayer service and filing programs discussed throughout this document.

We must quickly respond to those new technologies that will enable us to meet the ever rising customer expectations of better, faster, more secure services. We must build our systems using defined standards that will enable interchangeable and scalable systems that require only months to build instead of years. Additionally, our systems must be flexible enough to respond to the demands of the California Legislature at a moment's notice.

Managing Information as a Strategic Resource.

We already collect and maintain a tremendous volume of information and more is on the way. How we choose to manage and use this information affects the level of success we achieve in all our programs. That's why we look at information as a strategic resource.

Over the next few years, our Information Management Program will ensure that the right information gets to the right place at the right time. New information management systems, with their increasing levels of functionality, will have the capacities to use information to provide maximum levels of taxpayer service, and improve administrative efficiency and effectiveness. These efforts will help taxpayers fully realize the benefits of direct account access and are the basis for the future of interactive filing.

Our efforts to improve administrative efficiency over the next 10 years will support new developments in how taxpayers get information, file returns, and make payments. As we work to implement all of the new programs and systems that are a part of this vision, several factors will be critical to success. Let's take a look at what they are.

Critical Success Factors

New technologies and programs that we will implement over the next 10 years to improve taxpayer service, make tax filing and payment easier, and improve administrative efficiency will combine to create a system of tax administration in California that is dramatically different from the one we had just a few years ago. Because the changes will be so significant, there are a number of issues that we must address as we move forward. These 7 factors will be especially critical to realizing our vision.

Individual Taxpayers Must Use New Systems

The truest measure of success of our vision is whether taxpayers use the new programs and services offered. In some instances, taxpayers will benefit from new systems without any change in their behavior. For example, when taxpayers call us for assistance, customer service representatives will have better information with which to answer their questions and solve their problems. And, taxpayers who continue to file paper returns will receive their refunds quicker because of increased use of imaging technologies.

The taxpayers who will reap the greatest benefits, however, will be those who change how they currently interact with us. Those who file their returns electronically or over the telephone will receive the fastest refunds. Additionally, taxpayers who use a computer, public access terminal, or interactive television will have access to information including their own account information 24 hours a day, seven days a week. Moreover, eligible taxpayers who choose to participate in an interactive filing program will not have to file a return at all. Instead they will annually reconcile their FTB account much the same way that they reconcile their bank statement.

We anticipate that the tremendous benefits associated with using the new e-programs and services will prompt taxpayers to use them. In fact, the changes that we plan to implement over the next 10 years are in keeping with the larger technological changes that are sweeping across America. Therefore, many taxpayers will not only opt to use the new technologies, but will demand that we and other government organizations implement them so that they can use the same types of electronic services that they will enjoy in the private sector.

By all accounts, taxpayers are embracing our electronic filing option with open arms. Process year 2000 statistics show a nearly 17 percent increase in e-filers from the previous year. Disguised in that figure, however, is a statistic far more telling. The number of

taxpayers who used tax software to prepare and electronically file their own returns more than doubled in one year. Clearly taxpayers are finding a comfort level in e-service concepts. To ensure continued success of the implementation of new programs and services, we will engage market research techniques to determine how taxpayers prefer to access information, file returns, and make payments, and will implement new programs accordingly. Furthermore, we will make it a priority to build interfaces that are easy for taxpayers to use and understand.

Serving all of California's taxpayers will remain a priority for us. Although it is likely in the future most US homes will have a personal computer or interactive television, taxpayers who do not invest in these technologies will have electronic access to us through public access terminals. Most will have the option of filing returns and making payments over the phone. And, taxpayers, regardless of their personal investment in technology, will continue to interact with us through tax practitioners who will have the tools to interact electronically.

We Must Respond to the Needs of Business Taxpayers

Part of our vision is to reduce the cost and burden on California businesses trying to comply with tax requirements. One aspect of that is for businesses to extend their use of electronic commerce and information management into the tax arena, saving the time and effort associated with manually rekeying information and eliminating rekeying errors. Another aspect is for us to make it easier for businesses in California to understand and manage their income tax obligations by increasing their access to tax information including their own FTB account information. Especially critical to our success in reducing the burden on businesses, will be our use of more accurate and timely information. Identifying and resolving potential problems more quickly will reduce or avoid the penalties and interest associated with tax errors.

For businesses that pay other taxes in California such as employment or sales and use taxes, we will continue to work with the Employment Development Department and the Board Of Equalization. A seamless taxpayer interface will make it easier for businesses to get the information and assistance they need relative to all three types of taxes.

We will continue to work with the IRS and others to promote the greatest possible consistency between federal and state income tax programs. Like the PIT e-filing program, the data formats we

will use for our business entity electronic filing program will mirror those of the IRS as much as possible so that it will be easy for a business owner who files electronically with the IRS to do the same with us. A current effort that will help us position ourselves as we develop our business entity e-filing program is our involvement in the national STAWRS project. Should this project be successful in harmonizing employment tax reporting and payment requirements among federal and state agencies and in creating a single point of submission for employment tax filings and payments, it would make it considerably easier for many businesses to meet their employment tax obligations.

We Must Work Successfully With Private Sector Interests

Clearly, government does not function in a vacuum. In the area of tax administration, numerous private sector interests create tax-related products and services designed to help taxpayers meet their income tax and information reporting obligations to us. We must work successfully with all of these interests to ensure compatibility between their products, services, processes, and systems and ours.

For example, millions of taxpayers who use tax preparation software will file electronically. The flow of tax return data to us must be seamless and appear effortless to the tax preparer submitting the information. We will continue to work with software developers, transmitters, and networks to provide as many taxpayers as possible with the opportunity to communicate with us electronically.

Sixty-five percent of personal income tax filers and over 90 percent of business entity tax filers used tax practitioners to prepare and file their income tax returns in 1998. These numbers make it critical for us to continue to build on our established relationship with tax practitioners in order to meet our e-filing goals.

Other groups in the private sector are critical to the success of tax administration in California, because they provide necessary information to us and other government agencies. Employers provide information to Employment Development Department regarding the amount of wages earned by their employees. Financial institutions provide information to us or the IRS regarding the amount of interest earned by their account holders, mortgage interest paid by borrowers and income investment information provided by brokerage houses. Others provide information on payments made to independent contractors.

Our success in realizing this vision is partly dependent on the availability of all of this information in a timely, accurate, and complete manner. Additionally, according to a recent survey of

California taxpayers² they consider the cost associated with electronic filing a major factor when determining whether or not to e-file. Therefore, we will continue to work with information providers on our own and through our partnerships with federal and other state government entities to ensure the timely availability of complete and accurate information, while working to reduce the burden on, and cost to, the private sector interests that provide the information.

Safeguarding Privacy and Confidentiality

While electronic transmission of tax information and the ability of taxpayers to electronically access their own tax account information will make it easier for taxpayers to understand and meet their tax requirements, it also raises serious privacy and confidentiality issues. Because we place paramount importance on safeguarding taxpayer information, we will not move forward with any new project or program if we have not adequately addressed these issues on behalf of the taxpayers.

Taxpayer authentication.

Signatures have long been the primary method of authenticating the identity of individuals on tax returns and other paper documents. By eliminating paper, we also eliminate signatures and the laws and legal precedents associated with them. As we come to rely increasingly on the exchange of documents and information in electronic form, we must initiate new means of authenticating the identity of individuals with whom we interact. Whether they are filing a return from a home PC or electronically accessing personal account information from a public access terminal, we must be sure that individuals are who they say they are.

Fortunately, we are not alone in trying to address this issue. As society does more and more of its business electronically, the private sector and other government organizations are also working to find secure methods of authenticating the identity of individuals. We will continue to assess the viability of emerging methods for providing the level of authentication necessary to California's income tax programs.

² Lewis, Melinda and Minor, Pat. *The e-file Report*, Stakeholder Value Research Unit, California Franchise Tax Board, June 2000.

System Security.

The initiatives that we plan to undertake over the next 10 years will allow unprecedented access by outside parties to our information systems. While taxpayers will benefit greatly as a result, this increased access will pose increased risks to systems security. Therefore, a critical aspect of implementing our vision will be providing the level of access needed to implement new programs, while steadfastly protecting the integrity and security of our customers' tax information.

In order to meet this challenge, our systems have "firewalls" that limit an individual's access to only the appropriate programs and data. Systems are, and will continue to be, designed to constantly monitor activity to immediately identify any attempt to breach a firewall and track any illegitimate activity so that we can take immediate corrective action, as necessary.

Data transmission security.

Not only must we safeguard the security of information residing in our information systems, but also the security of information transmitted to and from our systems. We must build safeguards into the system to ensure that unauthorized parties cannot access messages including e-mail transmitted electronically between taxpayers and us. Today, data encryption is one method being used to secure data before transmission. We anticipate that encryption tools will become more sophisticated as we delve further into the e-commerce arena.

As we move forward with initiatives to increase the amount of tax information sent and received electronically, we will evaluate and employ encryption and other cost efficient methods of securing data transmissions.

Taxpayer Confidence in FTB.

Taxpayers want to know that we use the information they provide either electronically or on paper only for the intended purpose: to assist in the administration of the California income tax program. They also want assurances that their personal tax information will not be available to others. We understand that full success of our goals and vision depends on creating and maintaining a relationship of trust with our customers. As is the case today, all of our future initiatives will emphasize earning taxpayer trust. For example, we will continue efforts to ensure that those accessing FTB systems (including our employees) will have access to information on a "need-to-know" basis. Our security initiatives will continue to ensure that we provide the right information to the right person at the right time.

Implementing Cost Effective Technologies

New technologies offer tremendous potential for simplifying the lives of taxpayers and improving tax administration in California. At the same time, however, new technology implementation can be costly. In keeping with our proven record of accomplishment for successful technology implementation, we will commit to prudently implementing new technologies. When implementing new technologies, the value of establishing an electronic relationship with as many taxpayers as possible will be a driving force since it is critical to the overall success of our vision.

Our infrastructure has undergone a tremendous change over the past decade, particularly from the perspective of our employees. For example, we started the decade as a mainframe - dumb terminal environment where information navigation was cumbersome and on-line information was limited. E-mail was available for internal communication and between state agencies only. Only a select few employees within the department had access to PC technology and applications.

By mid-decade client servers sprouted up throughout the department with PCs grouped together and networked with each other based on functionality, creating islands of information with no connectivity from one server to the next. Although information was more available than at the beginning of the decade, if one needed information from a different server, one had to download and forward it either by paper or diskette.

We ended the decade with a completely networked environment where we converted our original mainframe into a super server, connecting all servers and information sources within the department for the first time. We have near unlimited access to information through our intranet and the World Wide Web. We can e-mail with, and send information to, anyone in the world who has an electronic mailbox, and all of this on one appliance, the desktop PC. We anticipate that the successes we have earned with the implementation of these changes will continue into the next decade.

Our systems and information architecture groups will ensure that future systems not only provide the functionality needed for specific programs, but that they will be designed within the context of the department's total business needs. This means that we will build new systems as pieces of a larger whole, rather than as a series of connected, but separate systems. As a result, each system will better leverage the investment in predecessor systems and provide a better foundation for future ones. Component-based system architecture will help us reach our goals in a cost-effective way and provide the flexibility needed to meet the demands of the taxpayer more quickly.

Finally, there are tremendous potential benefits associated with the implementation of our vision. In addition to the many benefits that will accrue to California's taxpayers, there are significant potential benefits to the state in the form of improved administrative efficiency and state revenue collection. The most significant of these benefits will occur in the following areas.

- *Improved self-compliance.* Too often, taxpayers either do not pay or underpay their income taxes because they do not fully understand their payment requirements. Making it easier and more convenient for taxpayers to get the information and assistance they need, and equipping our staff with more complete and accurate information with which to assist them, will improve taxpayers' understanding of their income tax obligations. This improves the likelihood that they will pay the correct amount of tax on time.
- *Better fraud detection.* More complete, accurate, and timely information will give us the means to better detect fraudulent tax returns during processing, before we issue a refund. In some cases, this will mean immediate identification of returns that misrepresent a taxpayer's wages, withholding, or other information in order to increase the size of a refund. In other cases, it will mean better identification of completely fictitious returns.
- *Enhanced compliance enforcement.* We commit to the fair application of tax provisions to everyone, so that no one pays more or less than his or her fair share under California's tax laws. In order to accomplish this goal, we have filing enforcement programs (to identify taxpayers who should have filed a return, but didn't) and audit programs (to ensure compliance with the laws). More complete, accurate and timely information and enhanced system capabilities will make these programs more efficient and effective by helping us focus on real problems to the benefit of compliant taxpayers and the state's general fund.
- *More effective collections.* Once we determine that a taxpayer owes taxes to the state, we begin efforts to collect the correct amount from the taxpayer. As a last resort, we will garnish a taxpayer's bank account or wages, or put a lien on any real or personal property of an unwilling taxpayer. More timely information regarding the whereabouts of delinquent taxpayer assets and the employment records of delinquent taxpayers will make our collection efforts more effective.

The IRS Must Take Similar Actions

Of course, individuals and businesses do not only pay income taxes to California. In fact, taxpayers and tax practitioners often focus more of their attention on federal income tax programs and requirements because of higher federal tax rates and because the state's program dependence on the federal procedures. Therefore, actions taken by the IRS can influence how responsive taxpayers are to state programs and requirements.

Our implementation of several new projects and programs that comprise our vision does not hinge on the implementation of similar projects and programs at the federal level. For example, opening new avenues for taxpayers to get information, supplying FTB customer service representatives with better information to use in responding to taxpayers and providing taxpayers with the option of filing returns over the telephone are all actions that we are taking independent of any federal programs. Although similar federal programs would be helpful in increasing taxpayers' awareness, they are not necessary for successful implementation and improvement at the state level.

There are two aspects of our vision, however, that depend on actions at the federal level. The first is obvious; building a more seamless interface between federal and state tax administration agencies clearly requires cooperation from the IRS and other federal agencies. Because many aspects of the IRS's vision in this area mirror that of the state, we are confident that we will build on the successful working relationship that has long existed between the state, the IRS, and other federal agencies. Examples of our successes in this area include the efforts of the California Fed/State Partnership. The partnership has produced several successful projects that allow us to optimize our resources so we can better meet the needs of California taxpayers including the "Striking Gold In California" project. This project's goal is to identify strategies and mentoring activities that will help the new small business entrepreneur find success in California. We will continue our active membership in the partnership and support new initiatives as they arise.

Our electronic filing programs are also somewhat dependent on the IRS, because the IRS electronic filing programs will heavily influence critical private sector interests (i.e., tax practitioners and software developers) in choosing to participate. Participation in electronic filing programs by tax practitioners is critical to program success because tax preparers submit 65 percent of all tax returns. Even though e-programs have expanded to allow for electronic

filing from home PCs, we anticipate that tax practitioners will continue to have more influence over the filing choice of the many taxpayers who employ their services. Federal electronic filing programs will have the greatest influence on whether tax practitioners participate in, and support, electronic filing programs and on software developers to develop tax preparation software that enable electronic transmission of returns. Based on continuing communications with the IRS regarding the future of federal electronic filing programs, state and federal efforts are consistent enough to support our vision in this area. Furthermore, we will continue to work with the IRS to implement state electronic filing programs in a manner that leverages implementation of similar federal programs.

Our Filing Vision Must Be Flexible

There has been a great deal of discussion recently at both the federal and state levels regarding income tax reform, including proposals to replace the existing graduated tax system with a flat tax or a percent of federal tax. While any change in income tax laws will potentially affect how we administer California's income tax programs, we believe that the principles that underlie our vision are key to the successful administration of taxes in any form.

For example, under any tax system, taxpayers will have questions and payment requirements and it should be easy and convenient for them to get help with either. At the same time, we should administer taxes with the greatest possible efficiency, and maximize revenue collection for the state.

We will continue a vision that embodies these principles. Although future tax law and policy changes will not influence our overall direction, they may influence the specific projects and programs we initiate over the next 10 years. Recognizing this, we will not proceed with any project without reevaluating the timing, scope, or continued desirability of the project in light of tax laws and policies in effect at the time.

Conclusion

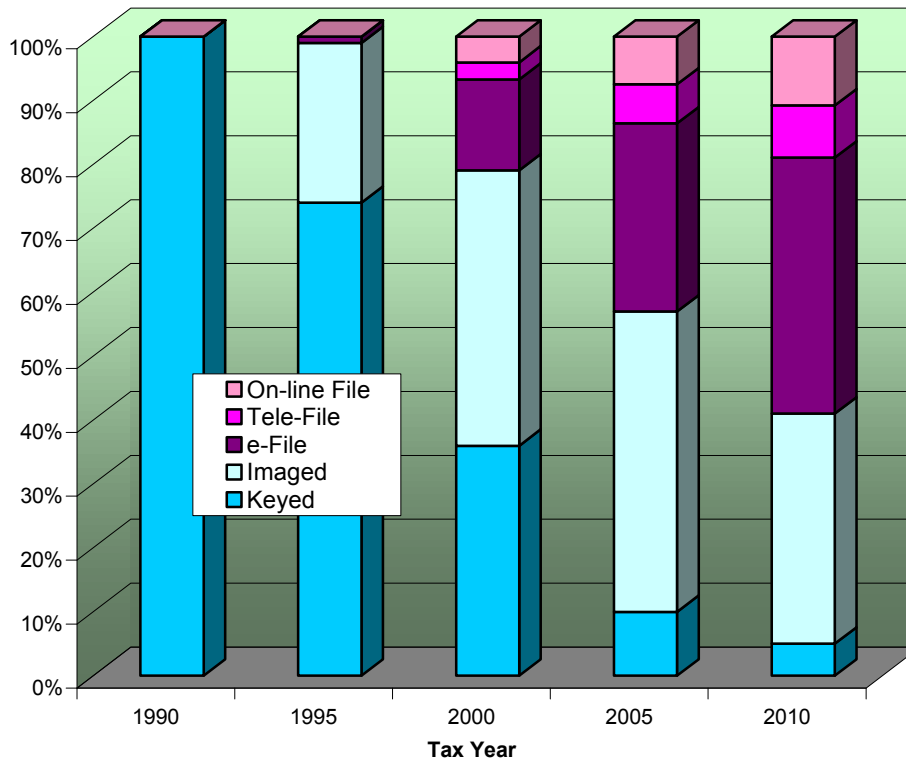
Many of our children will never experience a paper income tax form. Instead, they will pick up the phone, sit down at a PC, or use their interactive TV or their digital cell phone to file their income tax return. They'll also have the option of using any of these avenues to get the information and assistance they need, including their own tax account information and information on all types of state and federal taxes with a single contact.

In part, our vision is simply an effort to keep pace with larger changes that will continue to transform how individuals and organizations interact in our society. In other ways, we are affecting change by pioneering the application of new technologies and ideas in the area of state tax administration.

The key is to continue to provide our state with the best possible system of tax administration. One that makes paying taxes as easy as possible, provides for efficient government operations, and generates revenue for California through the fair and effective application of state tax laws. By building on past successes, working to resolve critical issues, and continuing to collaborate with appropriate private and public sector organizations, we are confident that in the 21st century we will witness the realization of this vision to the benefit of all Californians.

Appendix A — Personal Income Tax Returns

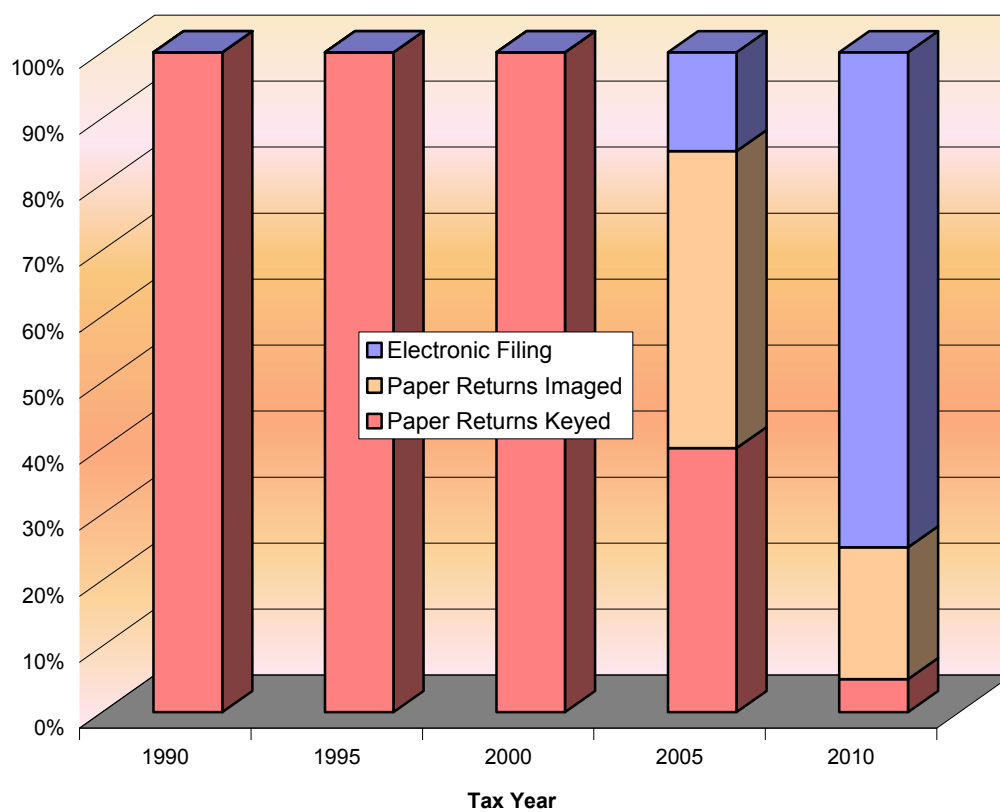
	Electronic Returns						Paper Returns		
	e-File		Tele-File		On-line File		Keyed	Imaged	
	low	high	low	high	low	high		low	optimum
1990		0%		0%		0%	100%		0%
1995		1%		0%		0%	74%		25%
2000		14%		3%		4%	36%		43%
2005	23%	29%	5%	6%	3%	8%	10%	60%	47%
2010	31%	40%	6%	8%	4%	11%	5%	54%	36%



NOTE: This graph illustrates an optimistic view of our PIT e-file program's future. We developed these figures using IRS e-file projections outlined in their Electronic Tax Administration, *A Strategy for Growth (2000)* publication. IRS presented their projections using 'high' and 'low' estimates. The high estimates illustrate optimism while the low estimates define a more pragmatic view. We mirrored their projection methodologies. The graph illustrates the high estimates.

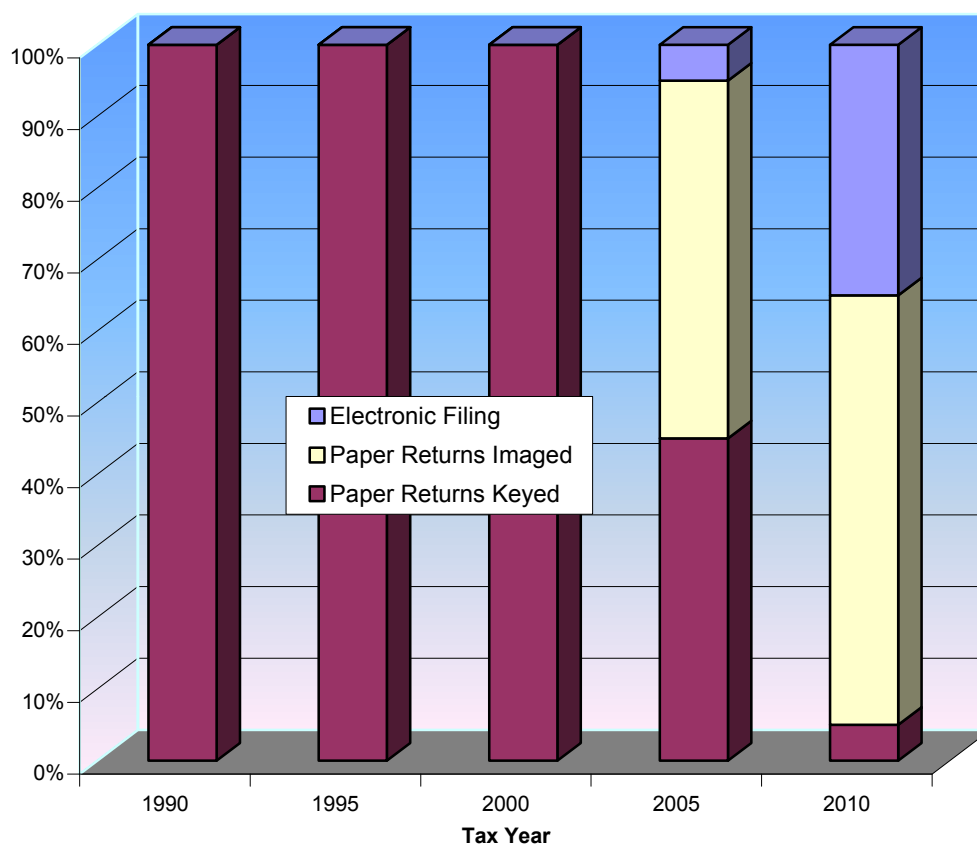
Appendix B — Partnership Tax Returns

	Electronic Filing	Paper Returns	
		Keyed	Imaged
1990	0%	100%	0%
1995	0%	100%	0%
2000	0%	100%	0%
2005	15%	40%	45%
2010	75%	5%	20%



Appendix C — Corporation Tax Returns

	Electronic Filing	Paper Returns	
		Keyed	Imaged
1990	0%	100%	0%
1995	0%	100%	0%
2000	0%	100%	0%
2005	5%	45%	50%
2010	35%	5%	60%



Appendix D — Payment Options

	Cash & Paper Checks	Electronic Banking Alternatives	Credit Cards
1990	100%	0%	0%
1995	99%	1%	0%
2000	93%	6%	1%
2005	77%	20%	3%
2010	45%	50%	5%

